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Trumpanomics Part II: Tax Reform, The First Act

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Trumpanomics Part II: The First Act of Tax Reform

Trump's Contract With America: Economic Plan The First 100 Days¹

The Economic Policy in Three Acts

An economic plan to create 25 million new jobs through massive tax reduction and simplification. In combination with trade reform, regulatory relief, and lifting restrictions on American energy

- **Middle Class tax relief and Simplification Act**
 - *Number of personal income brackets reduce from seven to three, and with simplified tax forms*
 - *Middle class family with two children will receive a 35% tax cut*
 - *Corporate tax rate reduced from 35% to 15%*
 - *Trillions of American corporate money overseas can now be brought back at 10%*
- **End of Offshoring Act**
 - Establishes tariffs to discourage companies from laying off workers in order to relocate in others countries and ship back to the US tax-free
- **American Energy and Infrastructure Act**
 - Leverages public-private, and private investments through tax incentives, to spur \$1 trillion infrastructure investment over ten years
 - It is revenue neutral

Questions Being Raised About the Plan

- Will it be revenue neutral?
- Will it disproportionately benefit the wealthy?
- Will business tax reform lead to substantially higher levels of domestic investments?
- Will taxes cuts and simplification create 25 million new jobs and sustainable growth over 4%?

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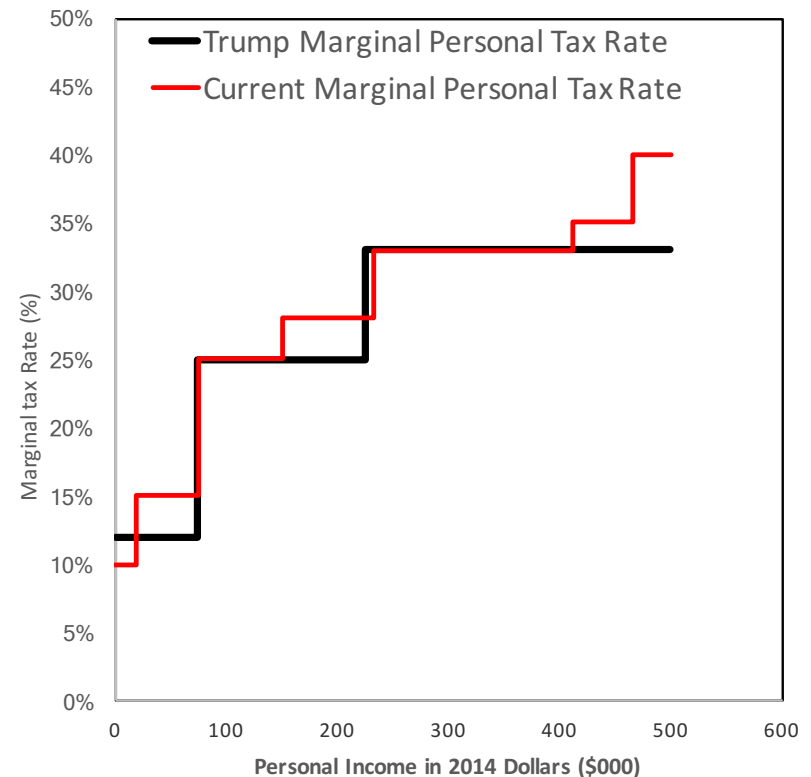
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Trump's Personal Income Tax Reform

The Key Parts of the Personal Income Tax Plan ¹

- Collapse the current seven tax brackets to three
 - 12%, 25%, 33%
- Increase standard deductions
 - Joint filers to \$30,000 from \$12,500
- Cap itemized deductions
 - \$200,000 for joint filers
- Eliminates the individual alternative min tax

The Marginal Personal Taxes Vs Current Levels ²



1. <https://www.donaldtrump.com/policies/tax-plan/>

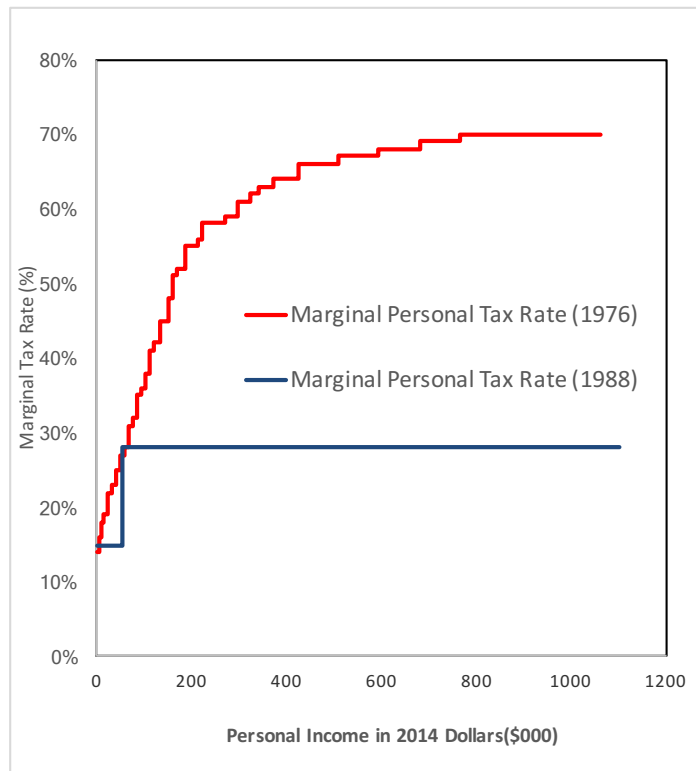
2. IRS

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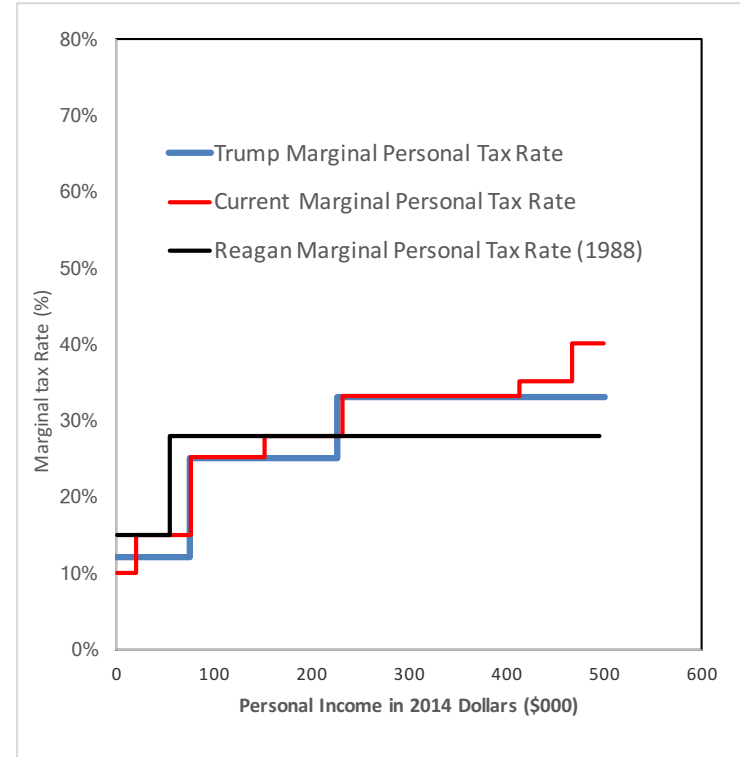
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Trump Personal Income Tax Cuts Are Not As Large As Reagan's 1981-86 Personal Income Tax Cuts

Reagan's "Flat" Tax vs Tax Code In 1976 ¹



Trump Plan Not A Big Change vs Current or vs Reagan ^{1,2}



1. Tax Foundation, Federal Individual Income Tax Rates History
2. <https://www.donaldtrump.com/policies/tax-plan/>

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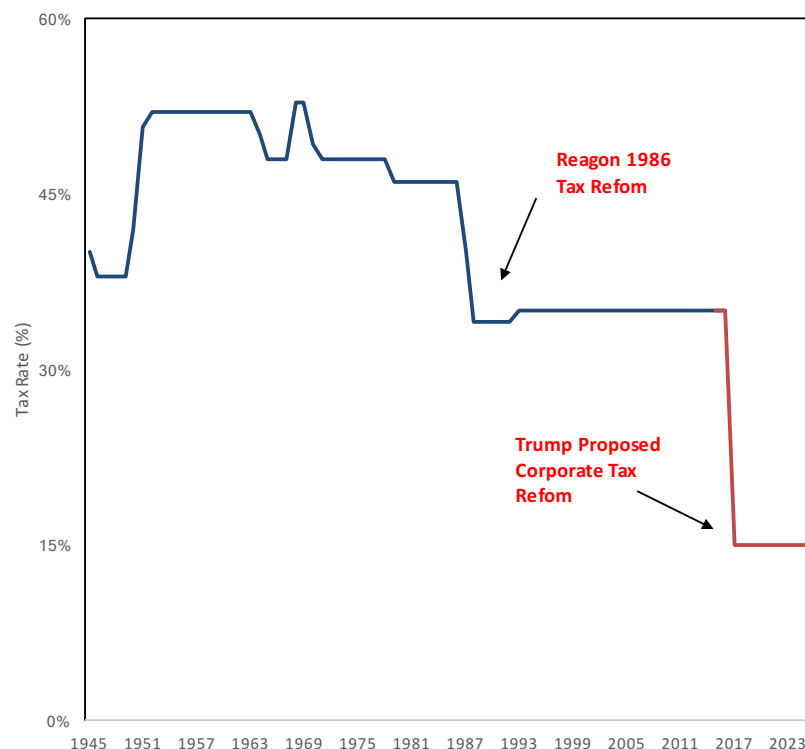
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Trump's Corporate Tax Reform

Key Features of the Corporate Tax Plan¹

- Reduces the corporate income tax rate to 15% from 35%
- Eliminate corporate alternative min tax
- Allow domestic manufacturers to expense capital investment and lose the deductibility of corporate interest
 - Currently, cost of capital investment is captured over the life of the asset
- Allowing repatriation of currently deferred foreign profits at a tax of 10%
- Reconcile tax treatment of pass-through business with that of C-corps

Corporate Tax Cut Significant vs Current and Vs Reagan^{1,2}



1. <https://www.donaldjtrump.com/policies/tax-plan/>

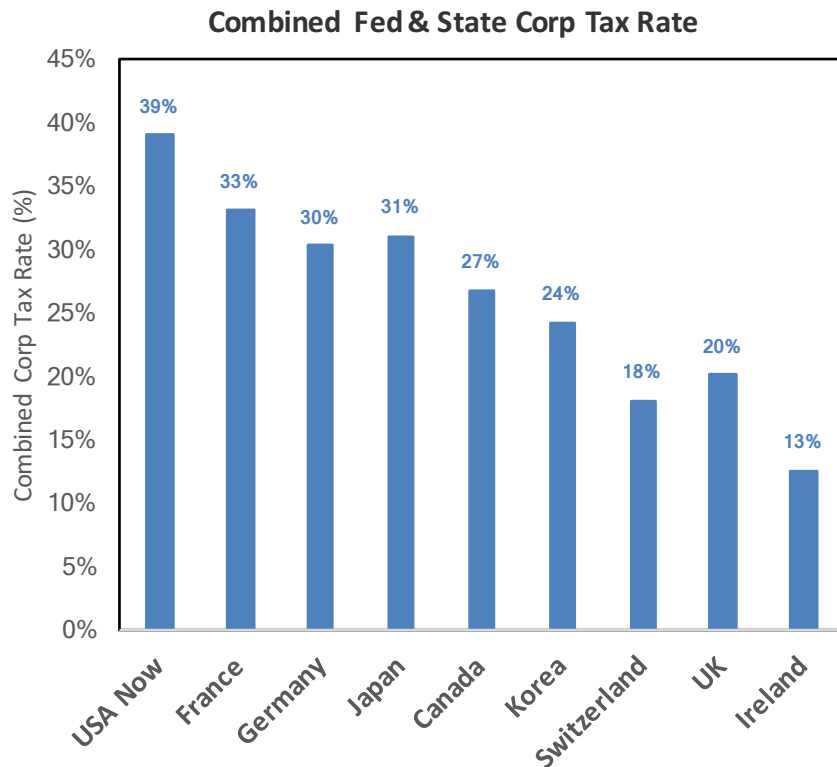
2. OMB

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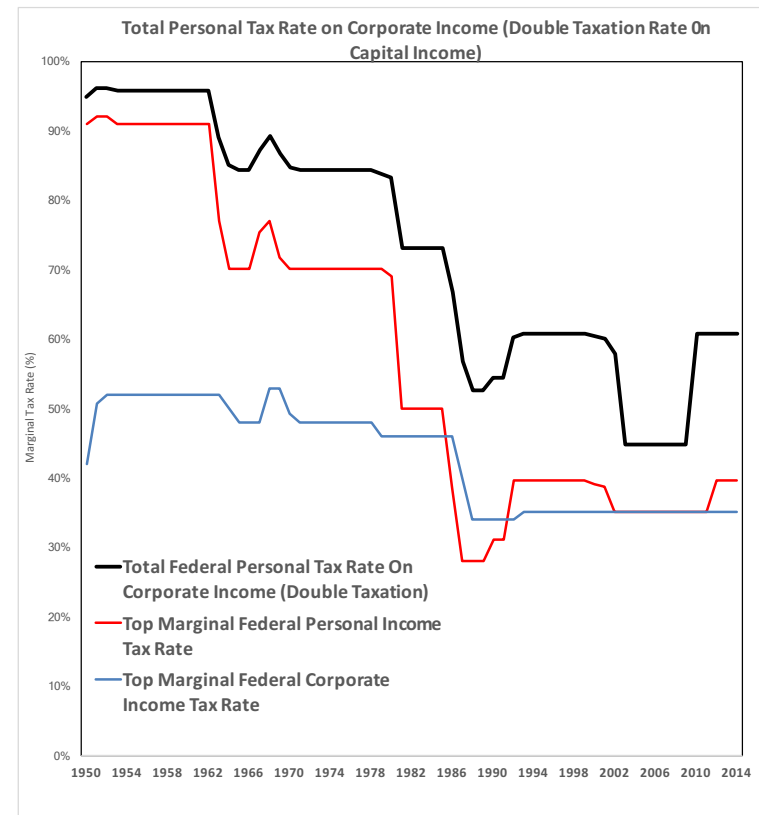
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The Need For Corporate Tax Reform

Statutory Corporate Rates Higher Vs Other Countries ¹



Double Taxation of Corporate Income Is A Barrier to Investment ²



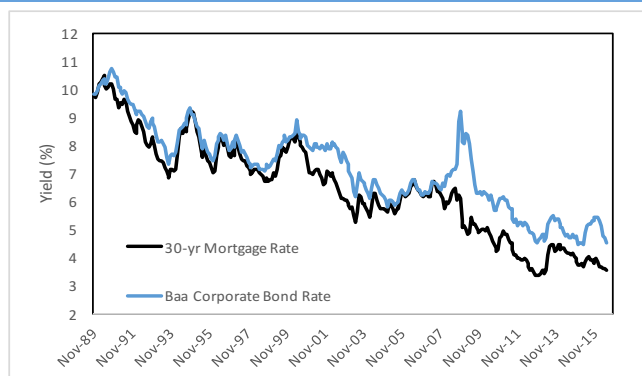
1. KPMG
2. IRS

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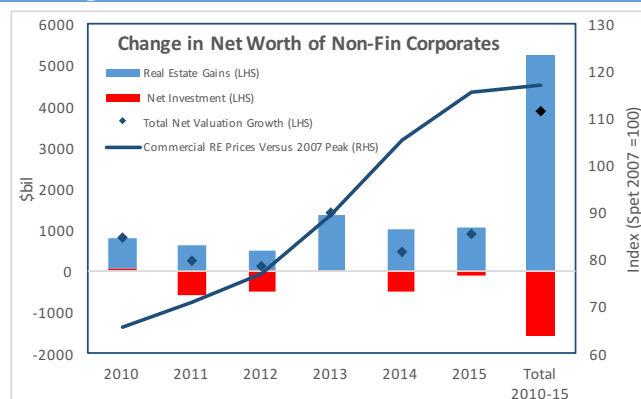
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Monetary Policy of Low Rates Have Created Asset Inflation, Negative Investment and Declining Productivity And Not Sustainable Growth

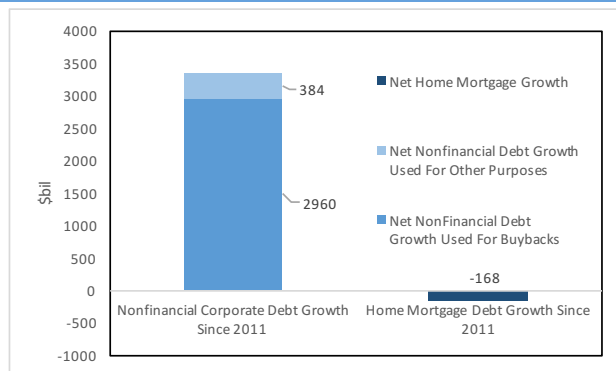
As A Result, Productivity Has Fallen Along With Investment Since the GFC¹



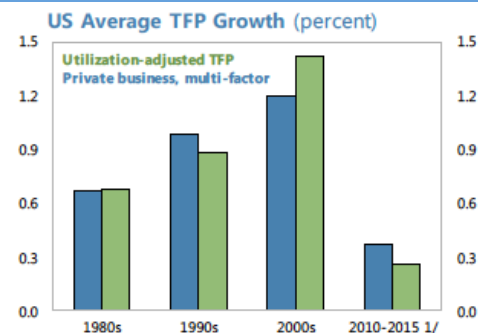
However, Corporates and Households Have Not Responded By Investing³



Policy Goal of Low Rates Was To Spur Growth Through Cheap Financing For Investment²



Low Rates Have Inflated Corporate Valuation Through RE While Net Investment Has Collapsed³



1. IMF, USA Article IV, June 2016

2. St. Louis Federal Reserve (FRED)

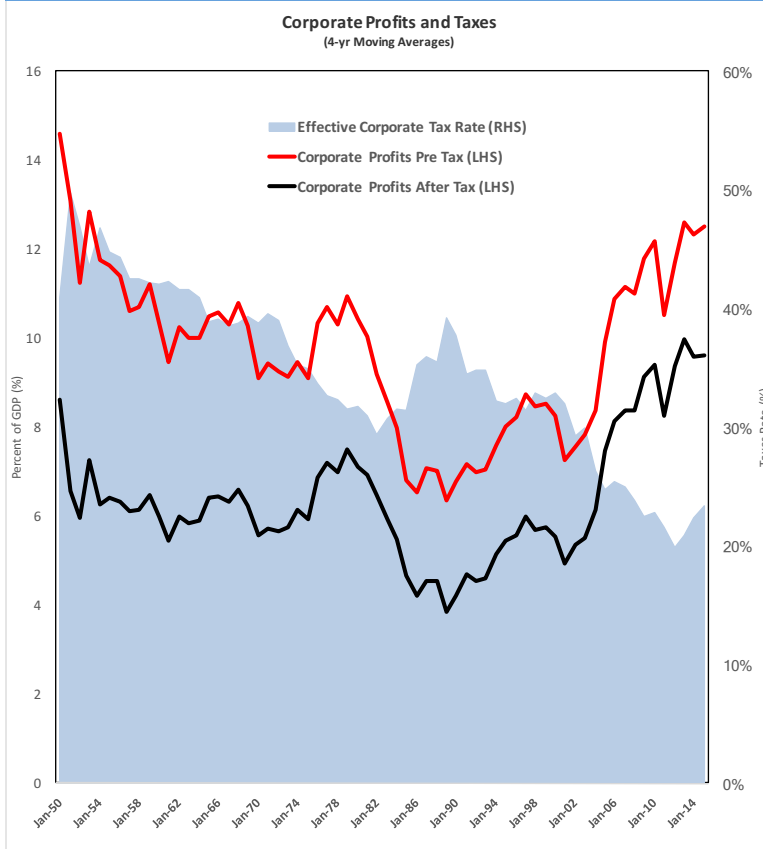
3. Board of Governors of The Federal Reserve, Flow of Funds Report

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High Corporate Tax Rates Create Tax Avoidance and Barriers to Investment

Effective Corporate Tax Rates Are Falling ¹

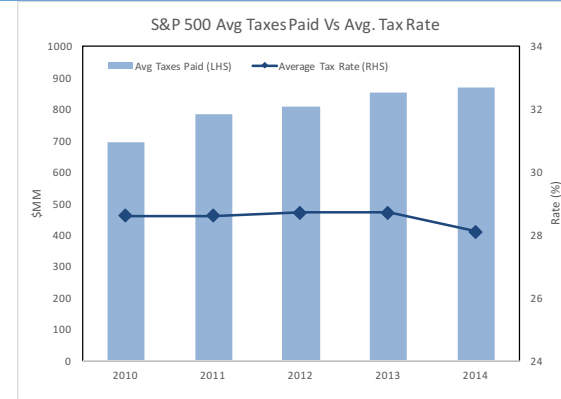


1. Federal Reserve Bank of St. Louis, Fred Data Base

2. Factset

3. GAO, Corporate Income Tax, GAO-15-363, March 2016

S&P Companies Pay Significantly Less than Statutory Rate ²



Effective Rate Even Lower Looking at Only Profitable Companies ³

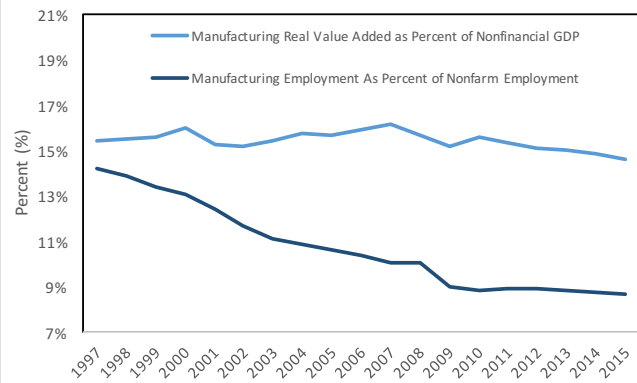


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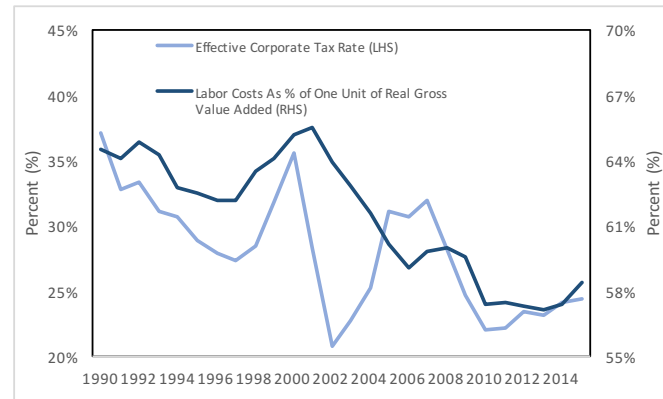
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Corporate Profit Growth Driven By Tax Avoidance and Lower Labor Costs At The Cost of Investment ¹

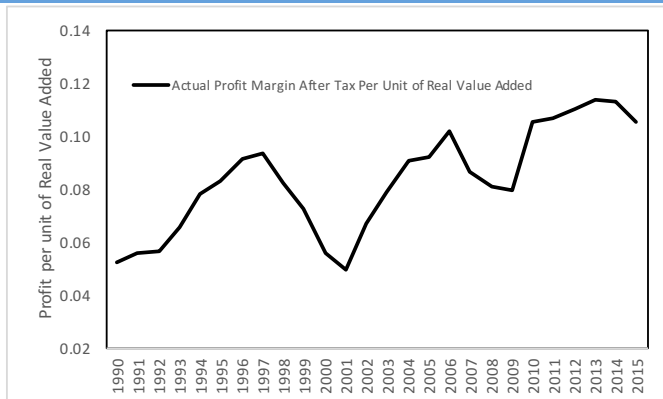
However, More Recently, The Impact on Profit Margins Has Slowed



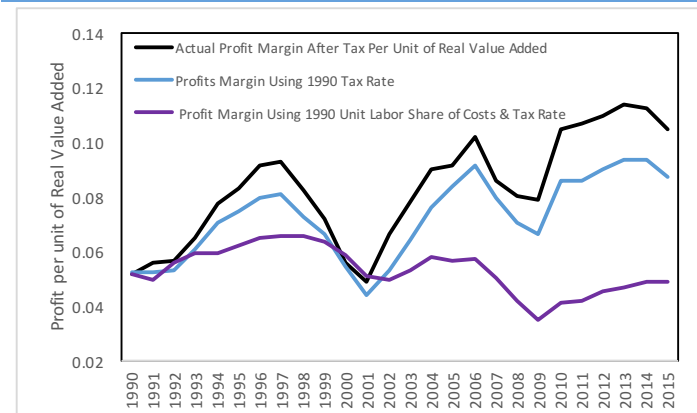
Taking Out Falling Taxes and Labor Costs, Profit Margin Are Down



Profit Margins Have Slowed As Taxes and Labor Costs Have Started To Rise



Productivity Gains Have Kept US Manufacturing Growing While Labor Force Fell

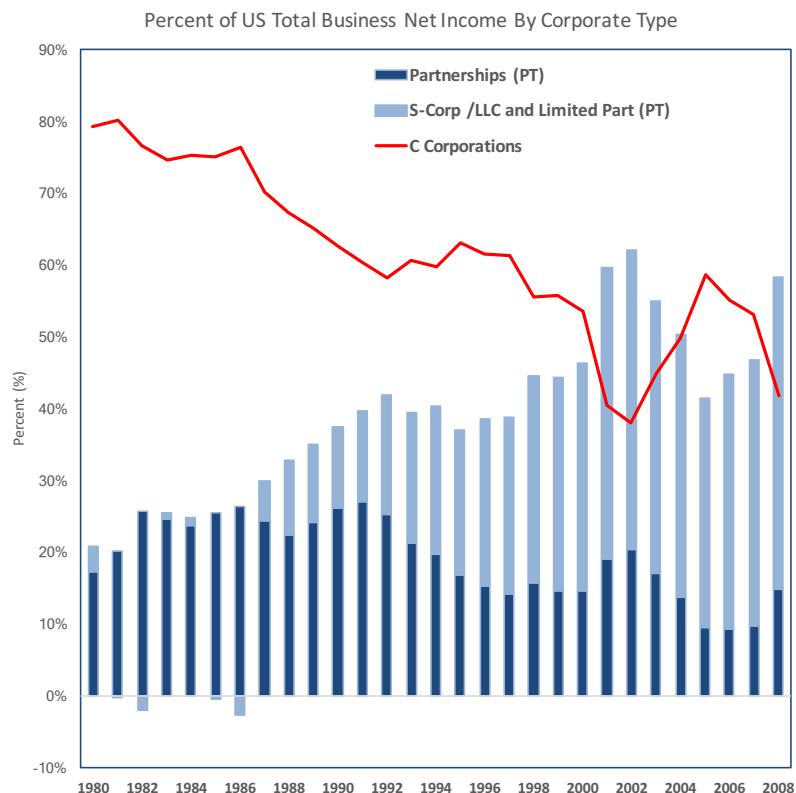


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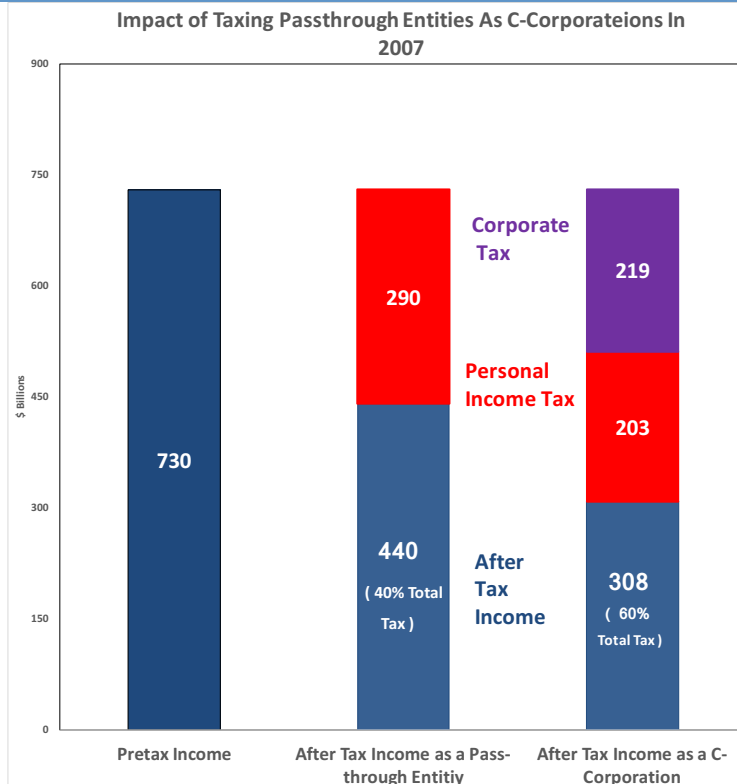
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Business Are Avoiding Double Taxation By Becoming Pass-Through Entities, e.g. S-corps and LLCs

Pass-Through Entities Growing as Share of Business Incomes¹



Pass-through Entities Pay Personal but Not Corporate Taxes²



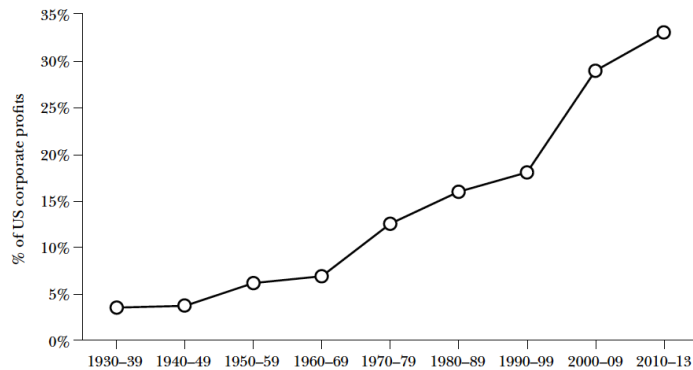
1. IRS
2. GAO

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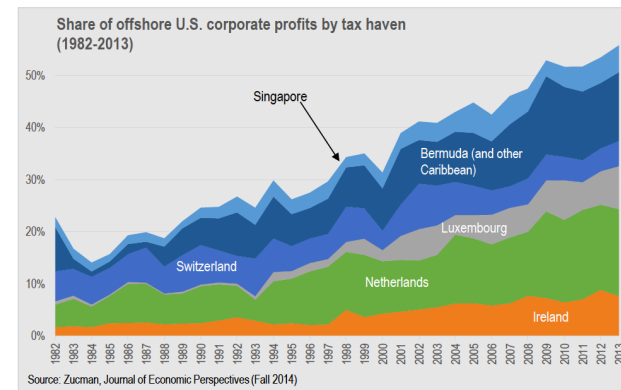
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C-Corporations Are Avoiding High US Corporate Tax Rates By Keeping Profits Overseas

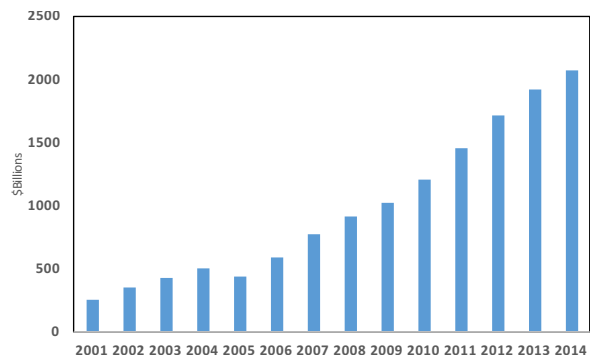
The Share of Profits Made Abroad By US Corporate Profits¹



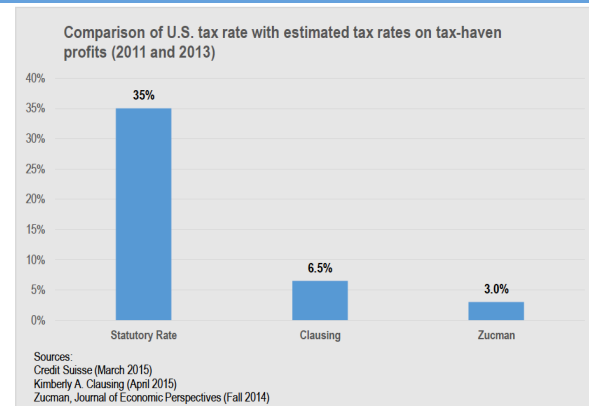
Over Half of Offshore Profits Held in Tax Havens³



US Corporate Profits Held Overseas²



US Corporates Pay About 5% on Profits Vs 35% If Repatriated^{1,3}



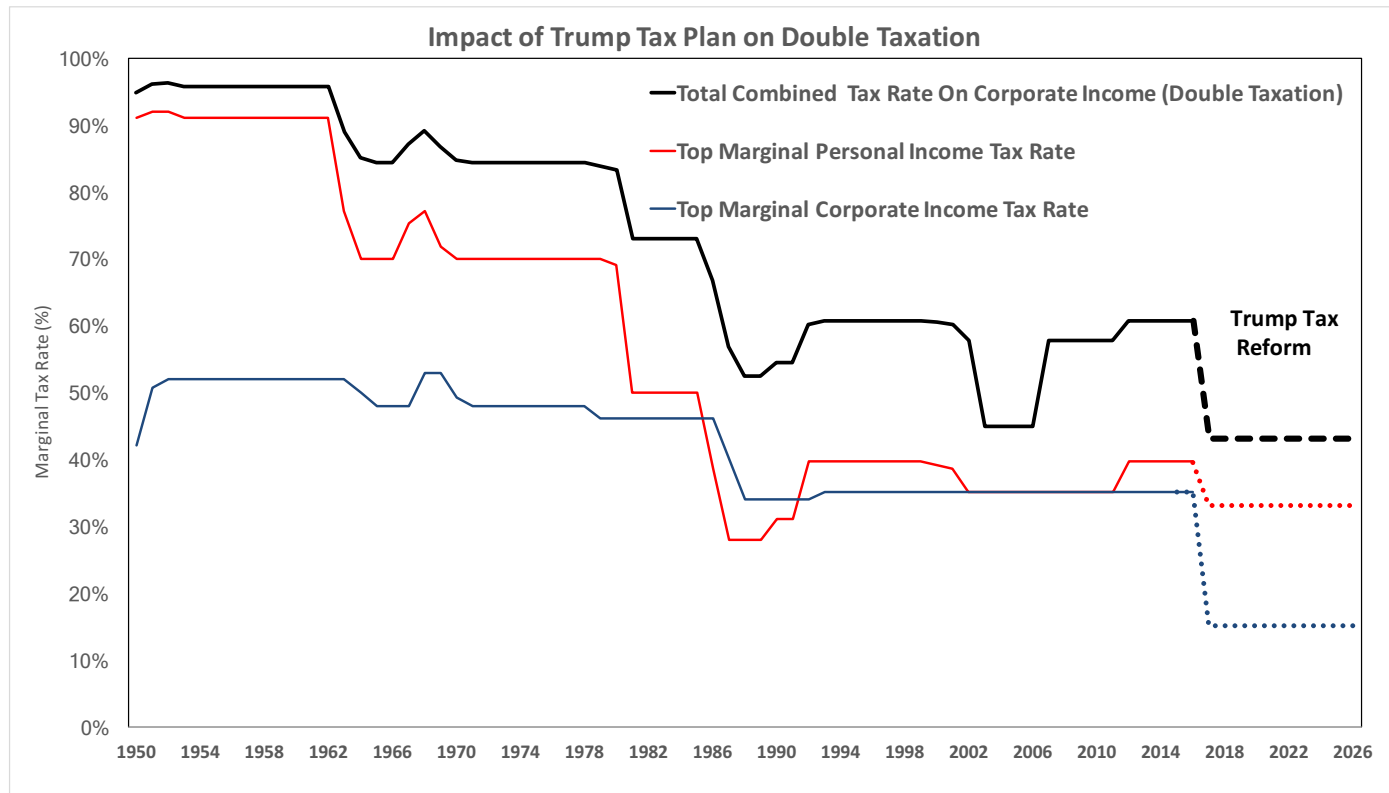
1. Gabriel Zucman, Journal of Economic Perspectives, *Taxing Across Borders: Tracking Personal Wealth and Corporate Profits* (Fall 2014), Figure 2, p. 128 and p. 130.
2. Credit Swiss Equity Research, "Parking A-lot Overseas", March 2015
3. Kimberly A. Clausing, *The Nature and Practice of Capital Tax Competition* (April 5, 2015), p. 10.

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Trump Corporate Tax Reform Will Attempt to Address These Issue

Difference Between Pass-through Taxes and C-Corp Taxes Narrowing ^{1,2}



¹ <https://www.donaldjtrump.com/policies/tax-plan/>

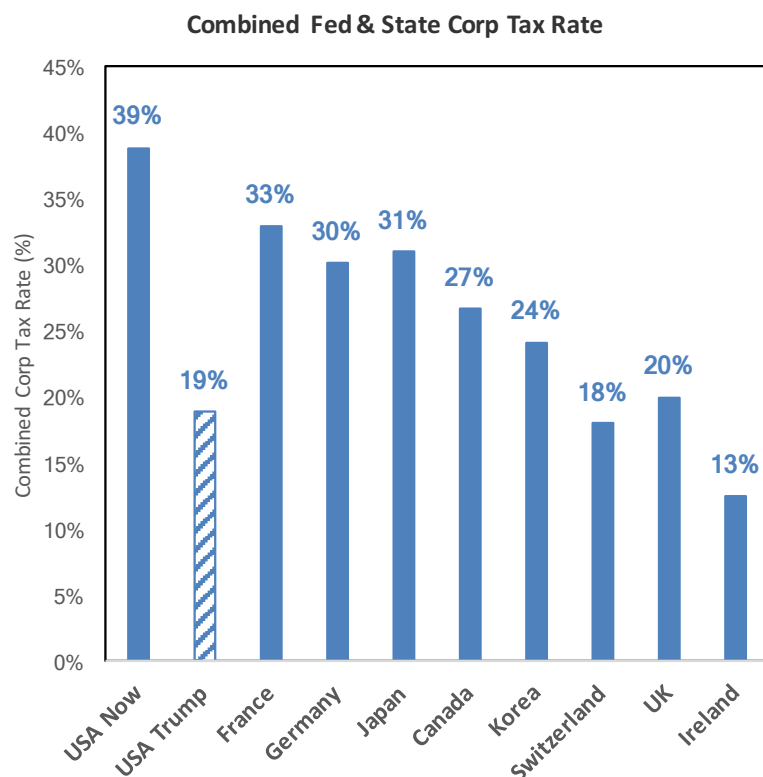
² OMB

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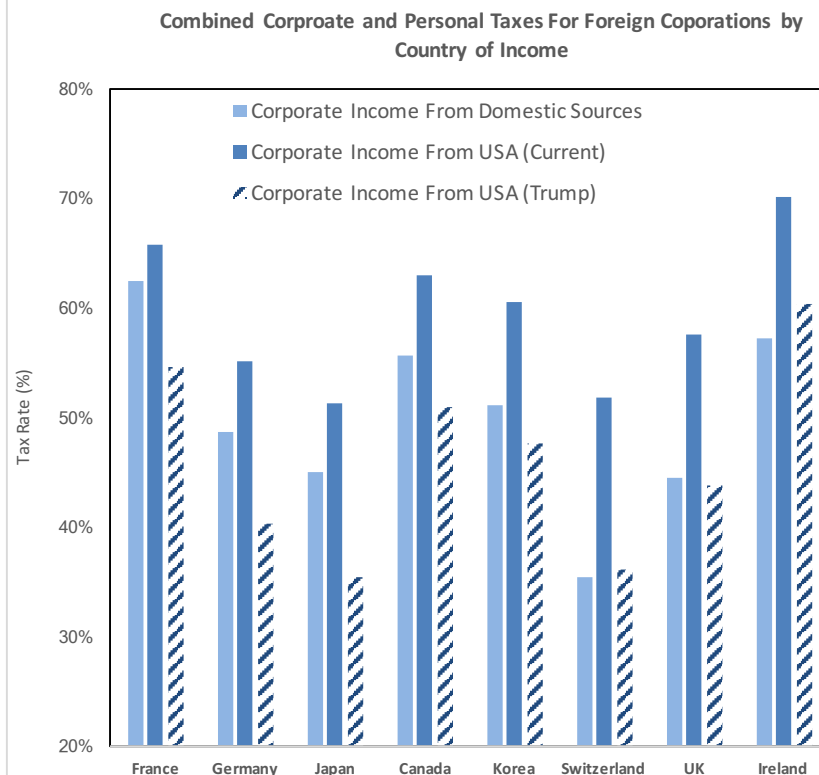
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Trump Corporate Tax Reform Will Attempt to Address These Issue

Foreign Investment Should Rise As US Offers Lower Total Tax Rates³



Trump Statutory Rates Looks Similar to Low Rates of Tax Havens^{1,2}



1. <https://www.donaldtrump.com/policies/tax-plan/>

2. OMB

3. OECD

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Trumpanomics Part II: The First Act of Tax Reform

Problems With The Current Plan Is That It Benefits Wealthy and Will Grow The Federal Debt Substantially

Tax Foundation (TF) Scoring of Plan ¹

Static and Dynamic Distributional Analysis

Changes in After-Tax Incomes

Income Group	Static	Dynamic
0% to 20%	1.2%	6.9% / 8.1%
20% to 40%	0.8%	6.7% / 7.9%
40% to 60%	1.3%	7.7% / 9.0%
60% to 80%	1.9%	7.9% / 9.0%
80% to 100%	4.4% / 6.5%	8.7% / 12.3%
90% to 100%	5.4% / 8.3%	9.3% / 13.7%
99% to 100%	10.2% / 16.0%	12.2% / 19.9%
TOTAL	3.1% / 4.3%	8.2% / 10.7%

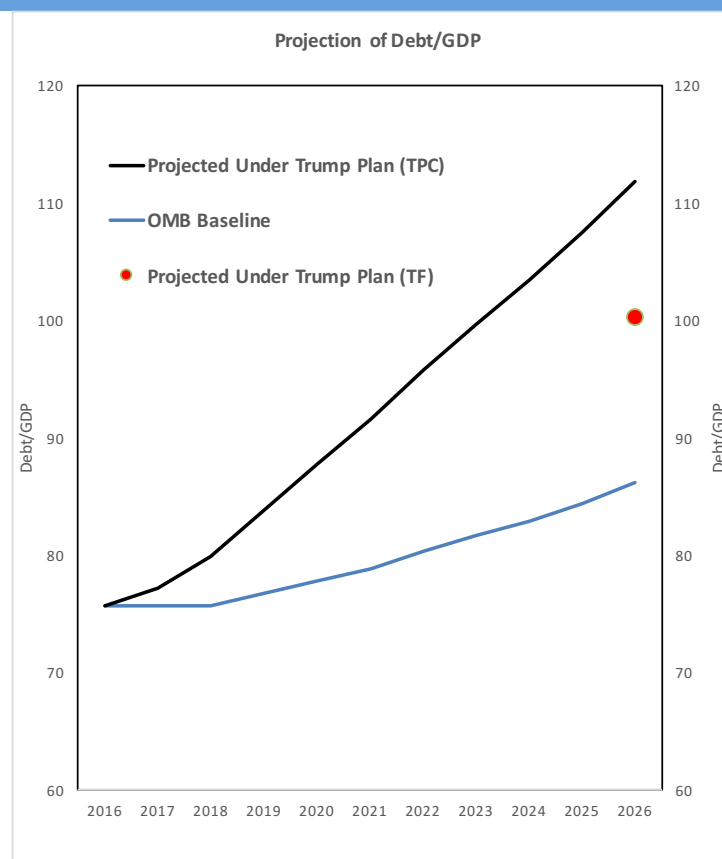
Source: Tax Foundation, Taxes and Growth Model (March 2016 version)

Tax Policy Center (TPC) Scoring of the Plan ²

Expanded cash income percentile ^{b,c}	Percent change in after-tax income (%) ^d	Share of total federal tax change (%)	Average federal tax change (\$)	Average Federal Tax Rate ^e	
				Change (% points)	Under the proposal (%)
Lowest quintile	0.7	0.8	-120	-0.6	3.7
Second quintile	0.9	2.2	-390	-0.8	8.0
Middle quintile	1.5	5.4	-1,090	-1.3	12.8
Fourth quintile	1.8	8.6	-2,120	-1.5	15.7
Top quintile	7.3	82.8	-24,440	-5.4	20.9
All	4.3	100.0	-4,020	-3.4	16.8
Addendum					
80-90	1.9	6.0	-3,380	-1.5	18.5
90-95	2.9	5.9	-7,170	-2.3	19.6
95-99	8.0	20.1	-31,610	-6.0	19.5
Top 1 percent	14.1	50.8	-317,100	-9.4	24.1
Top 0.1 percent	14.0	24.5	-1,459,720	-9.3	24.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-1).

TF and TPC Both Find The Plan As Being Financed By Debt Growth Not Income Growth ^{1,2}



1. Tax Foundation, Alan Cole, "Details and Analysis of the Donald Trump Tax Reform Plan, September 2016", No, 528
2. Tax Reform, The First Act Center, Jim Nunns, Len Burman, ect, "An Analysis of Donald Trump's Revised Tax Plan", October 18, 2016

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Scoring the Plan Shows That It May Not Create 25 Million Jobs and 4% Annual Growth

TF Model of Economic Impact of Trump Tax Policy ¹

GDP	6.9% / 8.2%
Capital Investment	20.1% / 23.9%
Wage Rate	5.4% / 6.3%
Full-time Equivalent Jobs (in thousands)	1,807 / 2,155

TPC Model of the Economic Impact of Trump Tax Policy ²

Economic Type	Keynesian Model/PWBM modMI
GDP	0%/-0.5%
Capital Investment	Negative
Wage Rate	Negative
Jobs	Negative

TF Model of The Cost of Trump Tax Policy (\$bill) ¹

Tax	Static Revenue Impact (2016-2025)	Dynamic Revenue Impact (2016-2025)
Individual Income Taxes	-\$2,192 / -\$3,730	-\$1,058 / -\$2,458
Payroll Taxes	\$0	\$520 / 612
Corporate Income Taxes	-\$1,936	-\$1,958 / -\$1,959
Excise Taxes	\$0	\$44 / \$52
Estate and Gift Taxes	-\$240	-\$240
Other Revenue	\$0	\$52 / \$62
TOTAL	-\$4,368 / -\$5,906	-\$2,640 / -\$3,932

TPC Model of The Cost of Trump Tax Policy (\$bill) ²

Tax	Static	Dynamic
Personal Income Taxes	-\$1,800/-3,300	-\$1,800/-3,300
Corporate Income Taxes	-\$2,600	-\$2,800
Payroll + Excise Taxes	0	\$100
Estate Taxes	-\$200	-\$200
Total	-\$4,600/-6,200	-\$4,500/-6,100

Source: Tax Foundation Taxes and Growth Model, March 2016.

Note: Individual items may not sum to total due to rounding. Numbers are listed with the higher-rate assumption first and the lower-rate assumption second, where applicable.

1. Tax Foundation, Alan Cole, "Details and Analysis of the Donald Trump Tax Reform Plan, September 2016", No, 528
2. Tax Policy Center, Jim Nunns, Len Burman, ect, "An Analysis of Donald Trump's Revised Tax Plan", October 18, 2016

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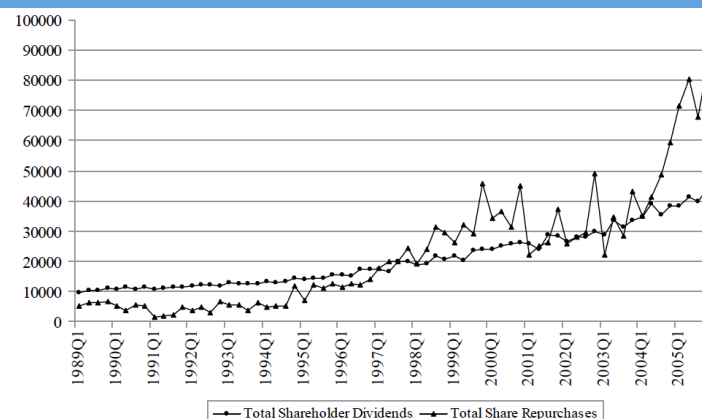
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In 2004, Repatriation Did Not Work To Reduce Incentive to Hold Overseas: The Lesson of Fungibility of Capital

The 2004 Repatriation Corporate Tax Holiday

- US companies could dividend back foreign held profits and be tax at at 5.25% rate
- Companies needed to file a plan that showed they were going to use it for investment not buybacks or dividends
- Roughly 40% of money came back and it seemed to be used to buyback stock and cut jobs

Corporations Appeared to Use Money For Buybacks...²



Profits Came Back From Tax Havens ¹

Country of Source of Dividends	Number of Corporatet Entities	Total \$billions
Netherlands	149	89.8
Switzerland	78	32.4
Bermuda	47	31.8
Ireland	68	25.6
Luxemburg	40	23.4
Canada	244	21.5
Cayman	55	18.4
UK	206	16.9
Other Countries		52.1
Total		311.9

And To Cut Jobs And Grow Profits Held Overseas ¹

Company	JOBS Act Repatriation Amount (\$ Billions)	Jobs Lost in 2005-2006	Pre-JOBS Act Accumulation of Foreign Earnings (two years, \$ Billions)	Post-JOBS Act Accumulated Foreign Earnings (\$ Billions)
Pfizer	37	10,000	29	60
CitiGroup	3.2	n/a	6	21
Merck	15.9	7,000	18	17
Hewlett-Packard	14.5	14,500	14	8
Proctor & Gamble	10.7	unspecified # lost	14	17
IBM	9.5	n/a	18	18
PepsiCo	7.5	200-250	9	15
Motorola	4.4	unspecified # lost	6	4
Honeywell	2.7	2,000	3	4
Ford	0.9	30,000-40,000	n/a	n/a
National Semiconductor	0.5	5% of workforce	n/a	n/a
Colgate-Palmolive	0.8	4,000	n/a	n/a

1. Congressional Research Service, Marples, Gravelle, "Tax cuts on repatriation earnings as economic stimulus" May 27, 2011
 2. Blouin, Krull, "Bringing It Home: A study of the Incentives surrounding the repatriation of foreign earnings und the American Jobs Creation Act of 2004", working paper, May 2009

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There Are Ways To Reduce the Side Effects of The Trump Plan: The Example of The House Republican Plan ¹

Elements of the House Republican Plan would make Trump Plan Revenue Neutral

Provision	Billions of Dollars, 2016-2025		
	Static	GDP	Dynamic
Eliminate the alternative minimum tax	-\$354	-0.3%	-\$428
Eliminate all itemized deductions except for the mortgage interest and charitable contributions deduction	\$2,331	-0.4%	\$2,218
Eliminate most personal credits	\$104	0.0%	\$104
Tax capital gains and dividends as ordinary income, allow a 50% deduction for capital gains, dividends, and interest	-\$609	0.3%	-\$531
Allow full expensing of capital investments	-\$2,236	5.4%	-\$883
Disallow interest deduction on new loans	\$1,194	-0.1%	\$1,176
Border adjust business taxes	\$1,069	-0.4%	\$936
Eliminate section 199 and all business credits, and limit net operating loss deductions	\$701	-0.1%	\$677
Repeal the estate and gift taxes	-\$241	0.9%	-\$20
Expand and consolidate the standard deduction, replace the personal exemption with a dependent credit, and expand the Child Tax Credit	-\$127	0.0%	-\$112
Consolidate individual income tax brackets into three of 12 percent, 25 percent, and 33 percent	-\$1,954	1.5%	-\$1,641
Tax income derived from pass-through business at a maximum rate of 25%	-\$515	0.6%	-\$388
Lower the corporate income tax rate to 20%	-\$1,807	1.7%	-\$1,325
Enact a deemed repatriation of deferred foreign-source income	\$185	0.0%	\$185
Move to a territorial tax system	-\$160	0.0%	-\$160

Plan Pays For Itself From Revenue Growth Economic Growth

Ten-Year Revenue Impact of the House Republican Tax Plan (Billions of Dollars)

Tax	Static Revenue Impact (2016-2025)	Dynamic Revenue Impact (2016-2025)
Individual Income Taxes	-\$981	\$566
Payroll Taxes	\$0	\$683
Corporate Income Taxes	-\$1,197	-\$1,324
Excise taxes	\$0	\$57
Estate and gift taxes	-\$240	-\$240
Other Revenue	\$0	\$68
Total	-\$2,418	-\$191

Source: Tax Foundation Taxes and Growth Model, March 2016.
Note: Individual items may not sum to total due to rounding.

Projected Economic Growth Even Higher

Economic Impact of the House Republican Tax Plan

GDP	9.10%
Capital Investment	28.30%
Wage Rate	7.70%
Full-time Equivalent Jobs (in thousands)	1,687

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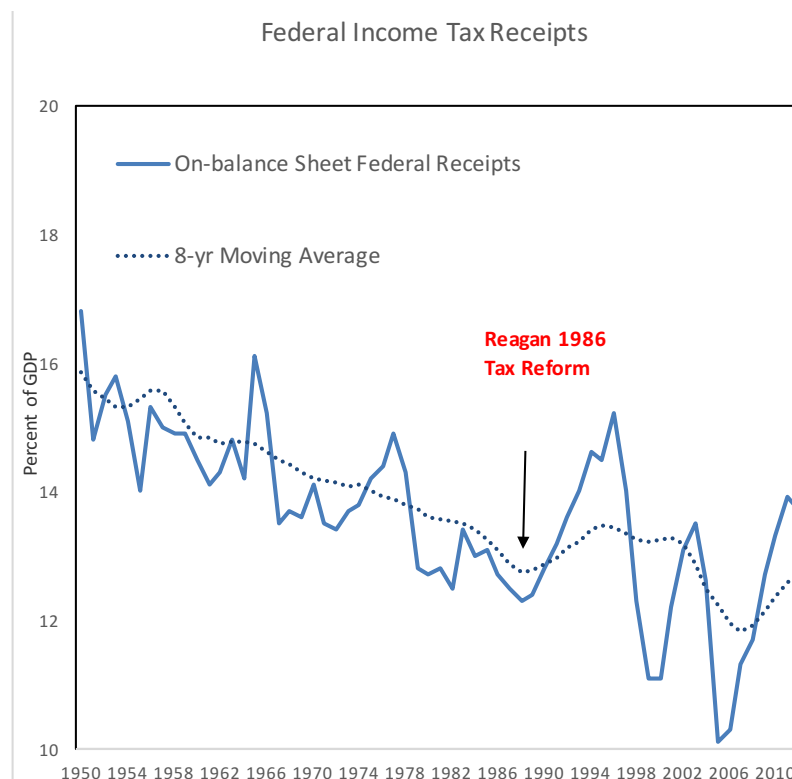
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Reagan Faced With The Same Trade-offs Made Tax Cuts Revenue Neutral

Reagan Tax Cuts and Trade-offs ¹

- Personal taxes
 - Brackets moved from 13 to 2 (12%,28%)
 - Deductions limited
 - Smaller IRA
 - Capital gains taxed as dividends
 - Higher AMT
- Corporate tax rates
 - Top bracket went from 46% to 34%
 - Repeal of investment tax credit
 - Lengthened depreciation life of structures
- Results
 - Was basically revenue neutral, tax cuts paid for by broadening base, reducing deductions and taxing capital and investments
 - **Net positive for households and negative for investment**

Tax Cuts Were Largely Revenue Neutral ²



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The Key For Trump Plan Will Be To Increase Investment In US Substantially By Reducing The Cost of Capital ¹

Consistent With A Simulations Studies Of A Zero Corporate Rate
(Impact Over First 2-yrs In US And ROW) ²

Category	Current law	Revised Trump plan	Change (percentage points)
Business investment	22.0	6.7	-15.3
Corporate	24.0	9.5	-14.5
Equipment	19.9	10.0	-9.9
Structures	27.9	10.0	-17.9
Intellectual property products	-0.1	5.1	5.2
Inventories	38.4	10.0	-28.4
Pass-through	18.9	2.6	-16.3
Equipment	15.5	3.2	-12.3
Structures	22.3	3.2	-19.1
Intellectual property products	-3.4	-2.5	0.9
Inventories	31.6	3.2	-28.4
Addendum			
Corporate (equity financed)	30.8	9.3	-21.5
Corporate (debt financed)	-7.4	10.1	17.5
Variation (s.d.) across assets	12.2	1.8	
Variation (s.d.) across industries	6.1	0.9	

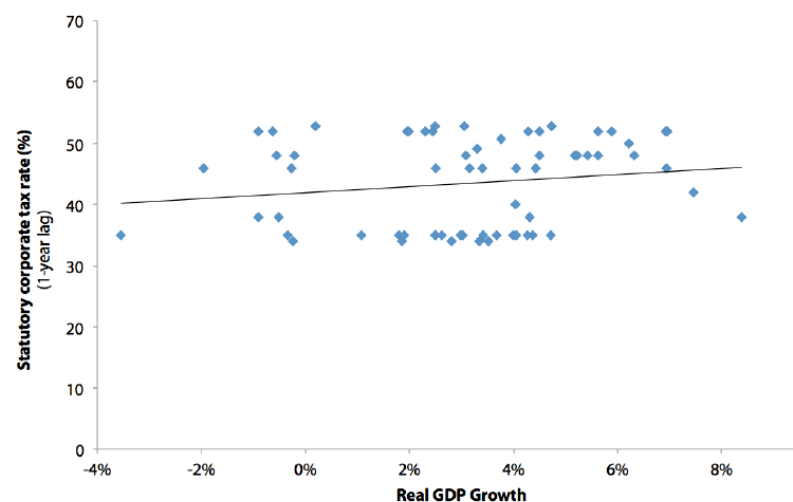
Source: Urban-Brookings Tax Policy Center calculations. See Rosenberg and Marron (2015) for discussion.

Looking At the Relationship Another Way ³

	GDP	Capital Stock	Consumption/GDP
USA	8.5%	24.0%	-7.0%
EU	-3.6%	-11.0%	1.2%
Japan	-3.9%	-11.5%	1.3%
China	-4.0%	-10.0%	0.0%

Growing GDP and Jobs Through Investment Growth Is Key: It Should Work in Theory But History....

Relationship between statutory corporate tax rate and economic growth, 1948–2010



Note: Each dot shows the real GDP growth rate for a particular year and the statutory corporate tax rate from the previous year. The line describes the relation between the two variables.

1. Tax Policy Center, Jim Nunns, Len Burman, ect, "An Analysis of Donald Trump's Revised Tax Plan", October 18, 2016
2. NBER, Hehr, Jokisch, Kamphampati, Kotlikoff, Simulating the Elimination of the US Corporate Income Tax" NBER Working Paper 1757, April 23, 2014
3. Economic Policy Institute, Thomas Hungerford, "Corporate Tax Rates and Economic Growth Since 1947", NO 364, June 3, 2013

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So, The Focus on Tax Cuts Misses the Larger Policy Moves that Could Reprice Markets By Translating The Lower Cost of Capital Into Creating A Renaissance of US Manufacturing

Trump Tax Cuts Alone Not Near Enough

- Will it be revenue neutral?
 - Not yet, could add between 2 to 7 trillion of new debt
- Will it benefit the wealthy?
 - Yes, though the middle class will benefit as well
- Will taxes cuts and simplification create 25 million new jobs and sustainable growth over 4%?
 - No, probably not alone, maybe 50 bp of real GDP per year, and about 2 million jobs
- ***The key to growth and the trade implementation is the other parts of the economic plan***

Tax Cuts Only Set the Stage For The Next Two Acts

An economic plan to create 25 million new jobs through massive tax reduction and simplification. In combination with trade reform, regulatory relief, and lifting restrictions on American energy

- Middle Class tax relief and Simplification Act
 - Number of personal income brackets reduce from seven to three, and with simplified tax forms
 - Middle class family with two children will receive a 35% tax cut
 - Corporate tax rate reduced from 35% to 15%
 - Trillions of American corporate money overseas can now be brought back at 10%
- ***End of Offshoring Act***
 - ***Establishes tariffs to discourage companies from laying off workers in order to relocate in others countries and ship back to the US tax-free***
- ***American Energy and Infrastructure Act***
 - ***Leverages public-private, and private investments through tax incentives, to spur 41trillion infrastructure investment over ten years***
 - ***It is revenue neutral***

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